

**IN THE
SUPREME COURT OF MISSOURI**

No. 83888

**MEDICINE SHOPPE INTERNATIONAL, INC.,
Appellant,**

v.

**DIRECTOR OF REVENUE,
Respondent.**

**On Petition for Review from the
Missouri Administrative Hearing Commission
Honorable Willard C. Reine, Commissioner**

REPLY BRIEF OF APPELLANT

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REPLY ARGUMENT

Pursuant to Missouri Supreme Court Rule 84.05(g) appellants Medicine Shoppe International, Inc. submits the following brief in reply to the Brief of Respondent Director of Revenue. Several portions of the Respondent's brief requires response and clarification.

A. Franchise Fees are distinct from interest income.

Respondent continually attempts to tie the management duties and obligations with respect to the Franchise Fees directly to the interest income from loans to Franchisees. These are totally separate functions. The Respondent has attached a copy of the License Agreement (Exhibit N) to his brief. It is important to note that financing and the interest due on the financing are not directly referenced in the License Agreement. The functions, duties and responsibilities Medicine Shoppe has to a franchisee under the license agreement are totally unrelated to the loan interest. The loans are purely optional and are covered by a separate note and security instrument (Exhibits HH, II). The security instrument is then recorded in the state in which the capital is utilized (Tr. 20).

B. The 1972 Legislative Changes do not affect the outcome.

The 1972 Legislative Change to Section 143.451 does not alter the result of *The Petition of Union Electric Company of Missouri*, 161 S.W. 2d 968 (MO 1942).

The Respondent makes a point of stating that the case of "Petition of Union Electric" was decided prior to the 1972 passage of Section 143.451 et seq. However, a review of the pre 1972 language reflects that the substantive language is the same. Section 11343, RSMo 1939 (Pre 1972) refers to "income from all sources in this state" and Section 143.451 refers to all "income derived from sources within this state." Therefore, the 1972 change would have

no impact on this matter.

The Petition of Union Electric Company of Missouri, 161 S.W.2d 968 (Mo. 1942) is still valid. Union Electric has stood for 60 years. The legislature could have changed the result in the 1972 amendment, but it chose not to do so.

The decision in *Union Electric* clearly states that income derived from a loan of money used by a non-Missouri entity wholly outside of Missouri is not Missouri source income under Section 11343. RSMo 1939. This Court determined that there are three sources from which income can derive: labor; capital; and profits derived from the sale or exchange of capital assets. *Id.* at 970. The court stated that the locus of the source of income is determined as follows: In the case of income derived from labor, it is the place where the labor is performed; in the case of income derived from use of capital; *it is the place where the capital is employed*;¹ and in the case of profits from the sale or exchange of capital assets, it is the place where the sale occurs. *Id.*, citing *In re Kansas City Star Company*, 142 S.W.2d 1029 (Mo. 1939). Medicine Shoppe's capital is used outside of Missouri on loans to new Missouri franchisees and the revenue is now Missouri source income.

C. Medicine Shoppe's Missouri actions are not the efficient cause of the interest income.

The Respondent has relied heavily (citing 11 times) on *Maxland Development v. Director of Revenue*, 960 S.W. 2d 503 (Mo. Banc 1998). This Court's determination in *Maxland* that the Michigan rental property was not Missouri source income is directly similar to Medicine Shoppe's loan interest. In *Maxland*, in regard to the Michigan property, this Court stated:

In *Maxland*, the lessors' only obligation was to restore the building if damaged or destroyed by fire or other peril. The initial term of this "triple net" lease was from 1963 through 1983, renewable thereafter for four five –year periods. The corporations and the one tenant amended the lease in 1971, but only to reduce the rent.

Clearly, Maxland had been involved in the leasing of the property, kept track of all rental payments and even was involved in the amendment of the lease. Medicine Shoppe is a similar situation. Medicine Shoppe performed the up front function of approving credit and executing and recording the loan documents. After the initial functions the only function by Medicine Shoppe was to collect the funds and track payments. This Court in *Maxland* found that, with regard to the Michigan property, it was a passive investment and the Missouri activities were not an "efficient cause" contributing directly to the production of income and therefore the resulting income as wholly without of Missouri. The same conclusion should be reached in this case.

D. Brown Group was properly decided.

This Court in *Brown Group, Inc. v. Administrative Hearing Commission*, 649 S.W. 2d 874 (Mo. 1983) stated that in construing the predecessor of Section 143.451¹ that subsection 1 of Section 143.040 RSMo 1969 actually imposed the tax while subsection 2 of the statute dealt only with how to compute the tax levied in subsection 1. . . So too, in subsection 1 of Section 143.451, a tax is imposed which includes all income derived from sources within this state . . ."

Contrary to Respondent's Brief the application of the Section 143.451.2 formula that

¹Emphasis added here and throughout, unless otherwise noted.

requires a corporation to include in Missouri taxable income, “all income from sources within this state including that from the transaction of business in this state and that from the transaction of business partly done in this state and partly done in another state or states” **arises only after** a determination that the corporation has “income derived from sources within this state” under Section 143.451.1.

Section 143.451 states:

1. Missouri taxable income of a corporation shall include all income derived from sources within this state.
2. A corporation described in subdivision (1) of subsection 1 of section 143.451 shall include in its Missouri taxable income all income from sources within this state, including that from the transaction of business in this state and that from the transaction of business partly done in this state and partly done in another state or states.

The statutory language is clear that only income from sources within Missouri is subject to Missouri corporate taxation. The legislature in section 143.451 did not state that all income is included but rather stated that “Missouri taxable income of a corporation shall include all income **derived from sources within this state.**”

The Missouri Supreme Court in *Wolff Shoe Company v. Director of Revenue*, Missouri Supreme Court, 762 SW2d 29 (1988) stated:

The primary rule of statutory construction is to ascertain the intent of the legislature from the language used, to give effect to that intent if possible, and to consider the words used in their plain and ordinary meaning. *Metro Auto*

Auction v. Director of Revenue, 707 S.W. 2d 397, 401 (Mo. banc 1986). And, where a statute's language is clear and unambiguous, there is no room for construction. *Id.* In determining whether the language is clear and unambiguous, the standard is whether the state's terms are plain and clear to one of ordinary intelligence. *Alheim v. F.W. Mullendore*, 714 S.W. 2d 173, 176 (Mo. App. 1986). Moreover, the plain and unambiguous language of a statute cannot be made ambiguous by administrative interpretation and thereby given a meaning which is different from that expressed in a statute's clear and unambiguous language. *Blue Springs Bowl v. Spalding*, 551 S.W. 2d 596, 600 (Mo. banc 1977).

The Respondent argues that *Brown Group* ignores the plain reading of the statute. However, the *Brown* decision was decided in April of 1983 and the Missouri legislature has had over 18 ½ years to legislatively change the outcome of *Brown Group* but has chosen not to do so. The reason the legislature has chosen not to change Section 143.451 in light of *Brown* may be that *Brown Group* correctly states the plain meaning of the statute as intended by the Missouri Legislature.

E. Medicine Shoppe is clearly distinguishable from the Nichols case.

Respondent has relied heavily on the Missouri Supreme Courts decision in *J.C. Nichols Co. v. Director of Revenue*, 796 S.W. 2d 16 9 (Mo. banc 1990). In the *Nichols* case the taxpayer developed, managed and sold real estate in Kansas and Missouri. The circumstances in *Nichols* are clearly distinguishable from the present case. In the *Nichols* case the taxpayer actively developed, managed and sold real estate in Kansas and Missouri. The taxpayer's

activities in *Nichols* were not passive. In addition, the *Nichols* case did not in any way change the Missouri Supreme Courts decision in *Petition of Union Electric Co. of Missouri*, 161 S.W. 2d 968 (en banc 1942).

F. The Respondent is attempting to create artificial distinctions.

The Director is attempting to create artificial distinctions with respect to the sources of investment interest income. The source of the funds for the loans to franchisees is excess cash. The same excess cash the Petitioner uses to invest in municipal bonds. The purpose of both the municipal bond interest and franchisee loan interest is to utilize excess cash accumulated from franchise fees and sales to franchisees. The Petitioner has chosen to utilize a number of low cost, low maintenance and high profit margin investment vehicles; the municipal bonds and loans to franchisees. The Petitioner's loans to Franchisee are a true passive investment of capital used outside the State of Missouri.

G. The source of income is not where the taxpayer's headquarters and management structure is located.

Respondent's argument goes directly against The Missouri Supreme Court in *The Petition of Union Electric Co. of Missouri*, 161 S.W. 2d 968 (en banc 1942). Respondent's argues that the Petitioner's headquarters and management structure is located in Missouri, the overall effort of the activities producing the origination fees and interest paid by out of state franchisees is in Missouri so that the income should be classified as income from sales partly within and partly without Missouri. This argument fails to appropriately apply the case law.

Under Respondent's theory a company headquartered solely in Missouri could not have non-Missouri investment income under Section 143.451 because the overall effort is directed

from the Missouri headquarters. This result is not supported by the state or the case law described herein.

CONCLUSION

For the above and foregoing reasons, this Court should reverse the decision of the Commission and determine that Medicine Shoppe's loan origination income and interest income does not constitute Missouri source income under the single factor method of apportionment.

Respectfully submitted,

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CERTIFICATE REQUIRED BY SPECIAL RULE 1(C)

I hereby certify that the foregoing brief includes the information required by Supreme Court Rule 55.03 and complies with the limitations contained in Supreme Court Special Rule 1(b). The foregoing brief contains 2,597 words.

The undersigned further certifies that the disk simultaneously filed with the briefs filed with this Court under Supreme Court Rule 84.05(a) has been scanned for viruses and is virus-free.

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